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SUBJECT: SED HAILED IN SECRETARY PAULSON'S MEETINGS
WITH CHINESE VICE PREMIER WANG AND FINANCE MINISTER
XIE

[11](#). (SBU) Summary. In separate meetings with PRC Vice Premier Wang Qishan (August 13) and Finance Minister Xie Xuren (August 12), Treasury Secretary Paulson emphasized the importance of sustaining the Strategic Economic Dialogue (SED). Paulson stressed that significant accomplishments are needed at SED V to demonstrate to the incoming U.S. Administration the benefits of the SED. Wang said both countries fully recognize the importance of the SED, which President Hu and Premier Wen have decided to prioritize as a platform to address difficult issues from a strategic perspective and resolve problems in a concrete manner. Minister of Finance Xie also hailed the SED for producing concrete outcomes while, more importantly, promoting mutual understanding and trust. Paulson, Wang, and Xie agreed that the Ten-Year Framework (TYF) on energy and the environment is important to both countries and should be significantly developed for SED V. Paulson confirmed to Xie that he will keep working to ensure the SED's durability during the transition, and cited progress on the TYF as well as the Bilateral Investment Treaty (BIT) and financial services as key priorities for SED [14](#).

[12](#). (SBU) Summary, continued: Turning to Doha, VP Wang noted that there were different readouts from Geneva, and suggested these issues were not helpful in moving to the next stage. Wang had told MOFCOM Minister Chen Deming to prepare a new plan to implement President Hu's desire for a successful Doha round. Wang said the JCCT would be a good venue for further discussions on Doha. Paulson reassured VP Wang that the U.S. government would continue to take resolute action to address stress in its financial sector, and Minister Xie praised Secretary Paulson's quick action to stabilize markets following the sub-prime mortgage crisis and the Fannie Mae and Freddie Mac "crisis." End Summary.

Future of the SED

[13](#). (SBU) In an August 13 meeting with Vice Premier Wang Qishan and Commerce Minister Chen Deming, Secretary Paulson stressed that the sustainability of the SED is important to support the U.S.-China relationship, which is the most important bilateral relationship in the world. Paulson stressed that

significant accomplishments are needed at SED V to demonstrate to the incoming Administration the benefits of the SED.

14. (SBU) Citing the meeting between President Hu and President Bush, Wang said that it is clear that both countries fully recognize the importance of the SED, and that the U.S. side is correct in its understanding that President Hu and Premier Wen are making the decision to prioritize this mechanism which provides a platform to address difficult issues from a strategic perspective and resolve problems in a concrete manner. "Both speak highly about the SED," he said. "In this they see eye to eye with President Bush." It contributed to good relations by providing a framework to discuss such issues as the international response to the Sichuan earthquake and stress in the U.S. financial sector. Wang also emphasized that China has not adopted any measures that would set back the issues discussed in the SED. Paulson agreed and noted that the SED has also been an important framework to address product safety concerns. Wang added that the U.S. and China have a long relationship and doubted that it would be easily changed by a new Administration.

15. (SBU) Paulson called the Ten-Year Framework (TYF) on energy and the environment the "centerpiece" of SED

14. Wang agreed that the TYF is important to both countries and expressed his desire to see it significantly developed for SED V. He said that he hopes to have concrete outcomes related to the TYF at

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every SED.

16. (SBU) In a separate meeting with Secretary Paulson on August 12, Minister of Finance Xie Xuren also hailed the SED, resulting not only in concrete outcomes, but also more importantly promoting mutual understanding and trust. He noted that with the upcoming change in U.S. administration, it was important to "institutionalize" the dialogue. Paulson confirmed to Xie that he will keep working on ensuring the SED's durability during the transition, and cited progress on the TYF, the BIT, and financial services as key priorities for SED V.

Bilateral Investment Treaty

17. (SBU) Paulson noted to VP Wang that the BIT does not have the same power to resonate broadly in the U.S. as the TYF, but that it is very important to continued and increased investment flows in both countries. Further, he expressed concern that it is controversial enough in both our countries that if enough momentum is not created by December, the new administration might not take it up. Given disagreements on core issues, getting enough done to create this momentum will require bold action by both sides.

18. (SBU) Wang responded that President Hu had called him after the meeting with President Bush and made a special mention of the BIT, and that Hu and Premier Wen responded positively to what Wang had proposed. Wang noted that Paulson's discussion with President Hu last April had helped break a long-standing stalemate on the issue. The Chinese side was pleased to hear that the U.S. is consulting with industry on what it sees as most important for the BIT. Wang stressed the U.S. and China should not conclude a BIT just to produce good news, but should reflect on what is in our mutual interest.

Next Steps

¶9. (SBU) Paulson stressed that continued incremental gains on financial services, such as what was agreed to in SED IV, was also a priority. While liberalizing equity caps on FDI in the financial sector remains a priority, if this is not possible in the near term, it would be helpful if CBRC and CSRC studies on foreign investment could signal positive momentum in the future.

¶10. (SBU) For SED V, Wang suggested focusing on easy issues first, as focusing on more difficult issues would not create a good atmosphere. Paulson agreed this was the right approach for the Ten-Year Framework, but for the BIT unless some of the toughest issues are tackled now, there is increased risk that the BIT will "die" in the next administration. Wang said, in that case, he would focus quickly on the BIT to understand better outstanding issues.

Doha

¶11. (SBU) Turning to Doha, Wang said he understood Lamy has decided to launch another round in September. He noted that there were different readouts from Geneva, and suggested these issues were not helpful in moving to the next stage. Wang noted that Chen's performance in Doha had been widely praised and that he gained respect and credibility from many of his counterparts, including Lamy and Mandelson. President Hu and premier Wen both heard President Bush's emphasis on Doha and the Chinese leaders want to see a successful Doha round. He had told Minister Chen to draw up a new plan to implement President Hu's desire to see a successful Doha round.

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¶12. (SBU) Wang said he will see Ambassador Schwab at the JCCT in September and suggested this would be a good venue to further discuss Doha. He also noted the importance of the JCCT as the venue to discuss in greater detail issues like IPR that have been raised in the SED. Further, he has already convened several meetings on the JCCT and is personally engaging in JCCT preparations.

Fannie Mae and Freddie Mac

¶13. (SBU) On the U.S. financial sector, Fannie Mae and Freddie Mac, Paulson reassured VP Wang that the U.S. government would continue to take resolute action. Paulson was grateful for China's understanding and patience and noted that there would be many opportunities to consult on developments in the months ahead. Minister Xie praised Secretary Paulson's quick action to stabilize markets following the sub-prime mortgage crisis and the Fannie Mae and Freddie Mac "crisis." Fannie Mae and Freddie Mac's problems, he speculated, derived from the size of their balance sheets, making them systemic risks. As financial innovation brought new products such as derivatives into the market, new regulation was needed. (Comment: As a major holder of Fannie and Freddie debt, Chinese officials have been following the recent situation closely. They now appear more at ease, following passage of U.S. legislation providing a line of credit, that the greatest risks to the GSE's creditors have passed. However, government and industry sources have told Emboffs that senior officials and bankers are still not distinguishing between GSE's debt and equity prices, and the USG's

efforts to safeguard systemic financial stability without bailing out shareholders. Thus many tend to see declines in equity prices as indications of increased credit risk. End Comment.)

Condition of China's Economy

¶14. (SBU) Minister Xie said China had successfully lowered its real GDP growth rate to 10.4 percent, within the target range, for the first half of 2008. While acknowledging that Chinese companies, particularly small- and medium-sized enterprises, are facing difficulties from higher input costs and lower demand, Xie posited that their troubles were due in part to their inability to access credit. (Comment: Many analysts say credit quotas have disproportionately impacted lending to SMEs, most of which have less established relations with the large state banks. End Comment.) Xie said the Chinese government wanted stable development and growth, but gave "priority" to curbing inflation. (Comment: This differs from recent Chinese official statements that called for "fast" growth and listed controlling price increases as only an important "task." End Comment.)

Earthquake Effect

¶15. (SBU) Xie said that beyond the devastating human toll and huge property losses, the May earthquake in Sichuan Province would have little effect on China's economy. He noted that reconstruction and increased government investment that follow natural disasters end up increasing GDP growth.

Comment

¶16. (SBU) Paulson's interlocutors made clear that Chinese senior leadership views sustaining the SED as an important anchor for strong bilateral economic relations. There was also clear support from senior leaders for the TYF and the BIT, though for the latter, no indications on whether this means the Chinese will agree to all core BIT commitments.

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Chinese economic officials appear comfortable with the stance they took in the Geneva Doha discussions, while at the same time, signaling they support a resurrection of negotiations. Among senior Chinese economic officials, interest in U.S. financial sector developments and policy responses remains high, first due to concerns about the impact on the U.S. real economy (and thus Chinese exports) and second due to concerns about the impact on Chinese official and bank holdings of US fixed income securities.

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